Supreme Court of the United States.

OCTOBER TERM, 1922.

No. 587.

ALVAH CROCKER ET AL., TRUSTEES,
PETITIONERS,
v.
JOHN F. MALLEY, COLLECTOR,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF FOR PETITIONERS.

The petitioners pray the Court to review the action of the Circuit Court of Appeals in reversing, on writ of error, a judgment of the District Court for the District of Massachusetts in favor of the petitioners, who were the plaintiffs in a suit to recover $5212 paid to the respondent Collector of Internal Revenue on January 3, 1919, as the Capital Stock Tax assessed to the petitioners as trustees of Crocker, Burbank & Co. Ass'cn,* under the Revenue Act of 1916, section 407, for the period July 1, 1918, to June 30, 1919.

* Note: This Crocker, Burbank & Co. Ass'cn, is the same as the former Wachusett Realty Trust which was before this Court in *Crocker* v. *Malley*, 249 U.S. 223, except that, after the decision of that case in its favor, it changed its form from that of a strict trust to that of an association. All its property is, however, still held by the petitioners as trustees of the Association.

Other and much larger amounts are involved in subsequent suits of the same nature.

In this brief the parties will be hereafter referred to as plaintiffs and defendant.

The Revenue Act of 1916 (39 Stat. 789) provided as follows:

> Sec. 407: "Every corporation, joint-stock company or association now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or any State or Territory of the United States shall pay annually a special excise tax with respect to carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to fifty cents for each $1000 of the fair value of its capital stock, and in estimating the value of capital stock the surplus and undivided profits shall be included * * *. The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year: Provided, that for the purpose of this tax an exemption of $99,000 shall be allowed from the capital stock as defined," etc.

The Revenue Act of 1918 (40 Stat. 1057) provided as follows:

> Sec. 1000: "Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1000 of so much of the fair average value

of its capital stock for the preceding year ending June 30, as is in excess of $5,000. In estimating the value of its capital stock the surplus and undivided profits shall be included.'"*

This Act of 1918 (with its increased rate, and lesser allowed deduction) was made retroactive, but provided that taxes already paid under the Act of 1916 should be credited the taxpayer.

The question is this:

Is a domestic association, existing under a deed of trust, liable to tax under either or both Acts if it has, in fact, no "capital stock" established by any provisions for capital or capital stock in its deed of trust, and has nothing in the way of shares other than trust receipts (without stated or par value) issued by the trustees of the association to the associates, representing merely fractional interests in a mixed fund.

The Collector claims that the tax was rightly assessed under the Act of 1916, and is rightly retained and credited under the Act of 1918.

The case was tried in the District Court without a jury. The plaintiffs showed that the association had no "capital stock," or capital which had ever been, in any way, by legal requirement, agreement, allocation, or otherwise, established as such, and claimed that, having no capital stock, it was not taxable under the Acts, or either of them, on the clear language of the Acts themselves.

The District Judge found that the association had no "capital" (Record, page 14). This finding is confirmed by plaintiffs' Exhibit 6, the trustees' balance

*Note: By definition in this Act the word "corporation" includes associations, joint-stock companies, and insurance companies.

sheet (Record, page 20). The form of plaintiffs' certificates of beneficial interest (Exhibit 5, Record, page 19), considered in connection with the provisions of paragraph 4 of plaintiffs' declaration of trust (Record, page 6), under which these ownership certificates were issued, makes it plain that there was no capital stock. The District Court found for the plaintiffs.

The Circuit Court of Appeals reversed the District Court and held, in substance, that the tax in question was to be "measured by the average amount of capital used during the tax year in doing the business" (Record, page 29 and page 30), and that the tax in issue, assessed not upon the "fair value of its capital stock" (it has no capital stock), but upon the basis of the net worth of the association, was valid.

The plaintiffs contend that this decision of the Circuit Court of Appeals is in violation of the clear wording of the Acts.

In these tax Acts it is plain that this special excise tax is levied only on corporations, associations, and joint-stock companies having a capital stock represented by shares.

It is a tax upon the privilege or facility of carrying on business in the form of a joint-stock company. So much is certain, whatever doubt there may be as to whether joint-stock companies or associations not organized under any statute are to be included, like ordinary stock corporations and joint-stock companies with statutory powers and privileges which are clearly subject to the tax on the principles established in *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, and *Eliot* v. *Freeman*, 220 U.S. 178.

A partnership association or an association organ-

ized under a deed of trust is not subject to the tax merely because it holds property and engages in business through its trustees or managing agents.

These plaintiffs were before this Court in *Crocker* v. *Malley,* 249 U.S. 223. It was there held that the plaintiffs were trustees of a strict trust. If so, their certificates of beneficial interest then outstanding were surely not then shares of "capital stock" in any sense whatever.

Can it be said that those same certificates, still outstanding, have become "capital stock" because, by amendment of the trust declaration, the association form has been adopted and some additional property acquired? No other change was made except that the trustees were authorized to carry on a manufacturing business.

The Errors Relied On.

The particulars in which the plaintiffs contend that the decision of the Circuit Court of Appeals was erroneous may be stated briefly as follows:

1. The Court construed the term "capital stock" as if the question had been one of determining what elements of value the term was intended to connote in a statute levying a property tax on corporations.

2. The Court dismissed as scholastic the distinction between shares of stock in a joint-stock company and shares of undivided equitable ownership in property held by the trustees of an association having no provision for "capital" or "capital stock" in the deed of trust by which it was created.

3. The Court construed a very slight verbal change in the statute as intended to effect a very great change in the nature of the tax, by subjecting to the tax, asso-

ciates carrying on business without any special authority, benefit, or privilege, derived from statute.

4. The Court seems not to have considered that a special excise tax cannot be, in effect, a mere property tax; that, to justify such taxation when levied "with respect to carrying on or doing business" by unincorporated associates, enjoying no special privilege or franchise of the kind described in *Eliot* v. *Freeman*, 220 U.S. 178, there must at least be found some distinguishing characteristic or feature of the form of organization under which the business is being carried on.

5. The Court resolved all doubts against the taxpayer.

EXCISE TAXES UNDER THE CONSTITUTION.

Congress can impose excise taxes upon particular occupations or kinds of business:

Spreckles Sugar Refining Co. v. *McClain*, 192 U.S. 397, 411.
Real Estate Title Ins. & Trust Co. v. *Lederer*, 263 Fed. 667.

It can levy excises in the form of stamp taxes on documents embodying or evidencing business transactions:

Thomas v. *United States*, 192 U.S. 363.
Nicol v. *Ames*, 173 U.S. 509, 519.
Malley v. *Bowditch*, 259 Fed. 809.

It can tax articles like liquor and tobacco manufactured for consumption and sale.

Patton v. *Brady*, 184 U.S. 608, 617.

It can levy an excise "with respect to carrying on or doing business" with the privileges which inhere in corporate or quasi-corporate capacity.

> *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 161.
> *Eliot* v. *Freeman*, 220 U.S. 178.
> *Roberts* v. *Anderson*, 226 Fed. 7

In deciding *Eliot* v. *Freeman, supra*, this Court adopted a construction of the tax Act which saved the excise in question from objections of the kind which were pointed out in *Minot* v. *Winthrop*, 162 Mass. 113, at page 121, in commenting on the case of *Gleason* v. *McKay*, 134 Mass. 419:

> "It is to be noted that the tax intended to be imposed was not upon a business or employment. The statute in terms applied only to certain kinds of partnerships, leaving other partnerships and persons doing the same kinds of business untaxed, *and the partnerships taxed possessed no special privileges derived from the Legislature*" (italics ours).

It is at least open to doubt whether Congress has power to levy an excise with respect to carrying on business by a common-law partnership, association, or trust, enjoying no statutory privileges, measured by the value of capital stock.

The validity of such an excise is rendered still more doubtful if "capital stock" is given no significance as limiting the tax to such organizations as have at least the distinguishing feature of a joint-stock company.

The Circuit Court of Appeals, by treating "capital

stock" as merely a term to describe the property to be valued, as used in many State tax laws levying property taxes on corporations, construes the tax as a tax upon the "net value of the association's assets."

So construed, it is submitted that the tax becomes a property tax in the guise of an excise.

In *Commonwealth* v. *Hamilton Mfg. Co.*, 12 Allen, 298, 301, Chief Justice Bigelow said:

> "It certainly cannot be contended that the legislature can legitimately impose a tax on property in the name or under the guise of levying an excise or duty. Such legislation would be a palpable evasion of a distinct and clearly defined constitutional restriction, * * *."

Congress, having no power to impose taxes on property without apportionment, could not levy taxes on capital stock of the kind described in such cases as the following:

Western Union Tel. Co. v. *Massachusetts*, 125 U.S. 530, 552.

Home Savings Bank v. *Des Moines*, 205 U.S. 503, 508, 510.

New York Central R.R. v. *Miller*, 202 U.S. 584, 593, 596.

Delaware, Lackawanna &c. R.R. v. *Pennsylvania*, 198 U.S. 341, 353.

Adams Express Co. v. *Kentucky*, 166 U.S. 171, 180, 182.

Adams Express Co. v. *Ohio*, 166 U.S. 185, 218.

NATURE OF THE TAX.

It is certain that the special excise tax known as the Capital Stock Tax, as imposed in the Revenue Act of 1916, section 407, and reimposed at a higher rate in the Revenue Act of 1918, section 1000, was intended primarily to apply to the same stock corporations, joint-stock companies, and associations that were subject to the so-called Corporation Tax of 1909, as construed in *Flint* v. *Stone Tracy Co.* and *Eliot* v. *Freeman,* 220 U.S. 107, and 178. If it be found that Congress intended to make the Capital Stock Tax apply also to a comparatively small number of common-law joint-stock companies, not organized under any statute, it must be on the theory that some characteristic or peculiarity of organization, common to all joint-stock companies, incorporated or unincorporated, although not in the nature of a special privilege or franchise, could lawfully be made the basis of an excise tax. What that distinguishing feature or peculiarity of organization was, upon the theory supposed, is very clear. The tax was imposed only on corporations and similar bodies having a capital stock represented by shares; and the value of the capital stock was made the basis for measuring the tax. From these considerations it is evident that the common characteristic of all these organizations, which Congress selected as justifying the imposition of an excise, was the doing of business with a capital stock represented by shares.

The Capital Stock Tax (Revenue Act of 1916 and Revenue Act of 1918) is an excise tax of the same nature as the Federal Corporation Tax of 1909 as construed in *Flint* v. *Stone Tracy Co.,* 220 U.S. 107, and in *Eliot* v. *Freeman,* 200 U.S. 178.

Congress, by employing in the Capital Stock Tax Acts substantially the same language that was used in the Corporation Tax Act of 1909, referred to above, must be presumed to have adopted the same construction of the language so used which had been adopted and declared by the Supreme Court in the cases above cited.

Edwards v. *Wabash Ry. Co.*, 264 Fed. 610.
Real Estate Title and Trust Co. v. *Lederer*, 263 Fed. 667.

The Corporation Tax of 1909 was "a special excise tax with respect to the carrying on or doing business," etc.

Identical language is used in the Capital Stock Tax, as enacted in the Revenue Act of 1916, section 407.

It is an excise of exactly the same kind, but adopting a different measure, *i.e.*, 50 cents (afterwards $1) per $1000, of the value of the capital stock.

Act of 1909 (36 Stats. at Large, 113-118).

(Corporation Tax)

Section 38. That every corporation, joint-stock company or association organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or under the Acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia, shall be subject to pay annually

a special excise tax with respect to carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to one per centum upon the entire net income, etc.

Act of 1916 (39 Stats. at Large, 789).

(Capital Stock Tax)

Sec. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say:

Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company, or association, or insurance company, equivalent to fifty cents for each $1000. of the fair value of its capital stock and in estimating the value of capital stock the surplus and undivided profits shall be included * * *.

The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year, * * *.

And provided further, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company, not

engaged in business during the preceding year, or which is exempt under the provisions of section eleven, Title I, of this Act.

The Capital Stock Tax was retained in title X, section 1000, of the Revenue Act of 1918 (so called, although not approved until February 24, 1919).

The section referred to imposed the same tax, but at an increased rate. The new tax was made retroactive, taking effect as of July 1, 1918, in lieu of the tax imposed by section 407 of the Revenue Act of 1916, and it was provided that taxes already paid for the corresponding period under the former Act should be credited in assessing the new tax.

The new provisions, title X of the Revenue Act of 1918, are as follows:

> Section 1000 (a). On and after July 1, 1918, in lieu of the tax imposed by the first subdivision of section 407 of the Revenue Act of 1916,
>
> (1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business equivalent to $1 for each $1000, of so much of the fair average value of its capital stock for the preceding year ending June 30, as is in excess of $5000. In estimating the value of capital stock the surplus and undivided profits shall be included.

The section, in terms, applies only to corporations, but it is to be read in connection with the general definitions in title I of the Act.

The definitions referred to are the following:

TITLE I

General Definitions.

Section 1. That when used in this Act the term "person" includes partnerships and corporations, as well as individuals.

The term "corporation" includes associations, joint-stock companies, and insurance companies.

The term "domestic" when applied to a corporation or partnership means created or organized in the United States.

It is to be noted that as the expressly prescribed and only possible measure of the tax imposed is the fair average value of the "capital stock," the section does not, in terms, and cannot be construed to, apply except to such corporations, associations, etc., as have a capital stock.

Substituting in section 1000 (*a*), (1), for the words "domestic" and "corporation" their definitions as given above, the section would read as follows:

(1) "Every corporation, association, of joint-stock company and insurance company, having a capital stock, created or organized in the United States, shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1. for each $1000. of so much of the fair average value of its capital stock for the preceding year ending June 30, as is in excess of $5000. In estimating the value of capital stock the surplus and undivided profits shall be included."

Thus we get substantially the language previously quoted from section 407 of the Revenue Act of 1916.

We do not find in section 1000 (*a*), (1), the expression, "organized for profit." If there are any corporations, associations, or joint-stock companies, carrying on business in the United States with a capital stock represented by shares, that are not "organized for profit"—which may well be doubted—then the Act of 1918 is wider in its application in this respect than the Act of 1916. But otherwise the only differences appear to be in the rate of tax (raised from 50 cents per $1000 to $1 per $1000) and in the amount of the exemption (reduced from $99,000 to $5000).

The excise imposed by the Corporation Tax Law of 1909 applied only to organizations having a capital stock, being so limited in express terms, "* * * every corporation, joint-stock company or association, organized for profit and having a capital stock represented by shares," etc.

The Capital Stock Tax, as imposed on "domestic corporations" by section 1000 (*a*), (1), Act of 1918, is also by necessary implication, limited to organizations having a capital stock, since the fair value of the capital stock is made the sole basis upon which the amount of the tax is to be computed.

The Act itself makes it perfectly clear that the term "capital stock" was not used in any loose, general sense, because in the same Act "foreign corporations" are taxed on the basis of "invested capital."

A still different method of computing the tax is provided for the case of mutual insurance companies, which have, of course, no "capital stock." Revenue Act of 1918, title X, section 1000 (2), (*c*).

These different provisions of the statute clearly indicate that Congress has used the term "capital stock"

in its usual and proper sense, and not as a loose expression intended to cover all assets and property, invested capital, or net worth.

In the bill as first passed by the House, section 1000 (*a*), (1), appears in the same form as that in which it was finally enacted. The Senate amended it by substituting a provision that the tax should be computed on "the excess over $5000. of the amount of its net assets shown by the books as of the close of the preceding annual period," etc. In conference the Senate text was stricken out and the section restored to its former tenor, providing that the tax should be computed on "so much of the fair average value of its capital stock for the preceding year ending June thirtieth as is in excess of $5000." etc.

The foregoing appears in the official copy of the Revenue Act of 1918, issued under date of February 6, 1919, entitled: (Committee Print—As Agreed to in Conference) 65th Congress, 3d Session, H. R. 12963.

The nature of the Corporation Tax was first settled in a group of cases in 220 U.S. 107, usually cited as *Flint* v. *Stone Tracy Co.*

It was then determined (1) that the tax was imposed not upon the franchises of the corporations irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate or insurance business and with respect to the carrying on thereof; (2) that it was a tax upon the doing of business with the advantages which inhere in the peculiarities of corporate or joint-stock organizations of the character described. (3) "As the latter organizations share many benefits of corporate organizations it may be described generally as a tax upon the doing

of business in a corporate capacity" (Opinion, page 146).

The language just quoted is very significant, and the same idea is expressed on page 151, as follows:

> "The tax under consideration, as we have construed the statute, may be described as an excise upon the particular privilege of doing business in a corporate capacity, *i.e.*, with the advantages which arise from corporate or quasi-corporate organization."
>
> "The requirement to pay such taxes involves the exercise of privileges, and the element of absolute and unavoidable demand is lacking. If business is not done in the manner described in the statute, no tax is payable."

And again, on page 161, at bottom:

> "The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business, without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of indi-

vidual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships. It is this distinctive privilege which is the subject of taxation, not the mere buying or selling or handling of goods which may be the same, whether done by corporations or individuals."

What Joint-Stock Companies or Associations are Included with Corporations?

The foregoing quotations from the opinion in *Flint* v. *Stone Tracy Co.* show that only such companies or associations are intended which may be said to have a quasi-corporate capacity, *i.e.*, as expressed in *Eliot* v. *Freeman*, 220 U.S. 178, 187: "only such corporations and joint-stock companies as are organized under some statute or derive from that source some quality or benefit not existing at the common law."

In *Eliot* v. *Freeman* the principle of *Flint* v. *Stone Tracy Co.*, was applied to certain Massachusetts real-estate trusts.

The Court says, page 185:

> "As we have construed the Corporation Tax Law in the previous cases, *Flint* v. *Stone Tracy Co.*, *ante*, the tax is imposed upon doing business in a corporate or quasi-corporate capacity, that is, with the facility or advantage of corporate organization. It was the purpose of the act to treat corporations and joint stock companies, similarly organized, in the same way, and assess them upon the facility in doing business which is

substantially the same in both forms of organizations. Joint stock organizations are not infrequently organized under the statute laws of a State, deriving therefrom, in a large measure, the characteristics of a corporation."

The foregoing language would be totally inapplicable to a simple voluntary association at common law, with no statutory powers or privileges, whether organized under a declaration of trust or otherwise.

Such companies are mere partnerships with transferable shares. It cannot be said that the mere feature of transferability of shares, established by agreement only, gives to such partnerships facilities "substantially the same" as those of a corporation, or clothes them "in a large measure" with the "characteristics of a corporation."

But it is contended on behalf of the defendant that, in the Capital Stock Tax Acts, Congress has intentionally used different language, of wider application than that used in the Corporation Tax Law of 1909, which was construed in *Eliot* v. *Freeman* and *Flint* v. *Stone Tracy Co.*

In support of this contention, reference is made to *Eliot* v. *Freeman*, on page 186, where the Court says:

> "The language of the act '. . . now or hereafter organized under the laws of the United States,' etc., imports an organization deriving power from statutory enactment. The statute does not say 'under the law of the United States, or a State,' or 'lawful in the United States or in any State,' but is made applicable to such as are

'organized under the laws of the United States,' etc. The description of the corporation or joint stock association as one organized under the laws of a State at once suggests that they are such as are the creation of statutory law, from which they derive their powers and are qualified to carry on their operations."

The defendant, relying apparently upon the foregoing extract from the opinion in *Eliot* v. *Freeman*, points out that in the Capital Stock Tax laws enacted since that decision, Congress has used the expressions, "organized in the United States," or "created or organized in the United States," instead of the expression "organized under the laws of the United States"; and argues that the wording was intentionally changed in order to include associations not organized under statute.

The Internal Revenue Department, in the administration of the capital-stock tax law, at first considered itself bound by the decisions of the Supreme Court made in the cases arising under the Corporation Tax Act of 1909, and ruled that "Massachusetts trusts" were exempt.

Treasury Decision 2418, December 15, 1916.

In 1918 the Department reversed itself, and ruled that "Joint-stock associations not organized under any statute and so-called Massachusetts trusts are subject to the tax."

This interpretation of the statute was adopted by the Internal Revenue Department in its Regulations

No. 38 (Revised) dated August 9, 1918, and in all subsequent revisions.

It may well be doubted whether Congress intended, by such slight verbal changes, to avoid the effect of *Eliot* v. *Freeman* and subject to the new excise-tax organizations neither organized under statutes nor deriving any powers or privileges from statutory enactment.

In another part of the Revenue Act of 1916 it may be seen that Congress knew how to use language clearly expressive of an intent to include with corporations other business associations not organized under any statute; for in Part II, section 10, relating to the Corporation Income Tax, it provided that the tax shall be levied "upon the net income of every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized," etc.

It is significant that the words "no matter how created or organized," were not inserted in section 407 of the same Revenue Act, the section which imposed the Capital Stock Tax; and it is not unreasonable to suppose that the omission indicates the intention of Congress that the Capital Stock Tax should be levied only upon the same class of corporate and quasi-corporate bodies that were taxed under the Corporation Tax Law of 1909, while at the same time making the income tax apply also to organizations created without statutory authority.

Such considerations were convincing in the District Court, as appears by the opinion of Morton, District Judge, in this case, giving judgment for the plaintiffs (Opinion, Record, page 17).

The District Court relied upon *Eliot* v. *Freeman*, and held that the word "association" was intended to bring under the tax all business organizations which resemble corporations in that they invoke special statutory powers in their organization; that the word ought not to be so construed as to change the basic character of the tax imposed. (Opinion of Morton, District Judge, Record, page 15).

But the District Judge also pointed out, rightly, we submit, that "capital stock" is by the Act made the basis and measure of the tax, and that many so-called "Massachusetts trusts" have no stated capital and no capital stock.

We quote from the Opinion in *Hecht* v. *Malley*, 276 Fed. 830; and as that opinion was by reference incorporated in the decision in the case at bar (*Crocker* v. *Malley*), the language quoted must have been used with reference to Crocker, Burbank & Co. Ass'cn:

> "The detailed provisions of the statute tend to support this conclusion. They make 'capital stock' the basis of assessment. Most corporations and certain kinds of joint-stock companies have a stated capital, so carried on the books and divided into shares. Many Massachusetts Trusts have nothing of that sort, being in this respect like a testamentary trust. The trustees are charged with the property which comes into their hands, and the shares represent an aliquot part of it and of the income which it produces. There is no special fund designated as capital stock. The taxes here in question were assessed upon the entire net assets of the trust; and it is contended by

the Government that 'capital stock' should be so interpreted. But in the very next section to that under which the tax is levied the Act refers to 'invested capital,' and taxes foreign corporations on that basis. The distinction between 'capital stock' and 'invested capital' is there recognized in the Act itself. The section also provides that 'in estimating the value of capital stock the surplus and undivided profits shall be included,'—which is only applicable to organizations in which there is a capital fund distinct in bookkeeping from the other assets. Such a fund is required in the accounts of the ordinary corporation and many joint-stock companies; it is not required of a trust, although some of them do carry such an account'' (Record, page 18).

Whether or not the plaintiffs are entitled to judgment upon the sole ground that Crocker, Burbank & Co. Ass'cn is not an association organized under any statute, we submit that they are entitled to judgment upon the ground that said association has no capital stock.

Capital Stock.

The plaintiffs contend that if this special excise tax applies to any business associates other than ordinary stock corporations and joint-stock companies, it can be extended only to such other bodies as possess the distinguishing feature of a joint-stock company, namely, a fixed capital stock represented by shares.

> ''The fundamental difference in the constitution of business corporations from the earlier

forms which preceded them is the joint-stock capital, and most of the law peculiar to this class of corporations relates to that difference, and the consequences which follow from it."

II Harvard Law Review, "History of the Law of Business Corporations Before 1800," Williston, p. 149.

And in the first part of the same paper, in II Harvard Law Review, p. 109, Prof. Williston says that it was one of the claims to favorable consideration which the East India Company put forward, that "noblemen, gentlemen, shopkeepers, widows, orphans, and all other subjects may be traders, and employ their capital in a joint stock."

In an article entitled, "The Capital of a Corporation" XXII Harvard Law Review, p. 319, George W. Wickersham says:

"The general idea of *corporate capital* running through the statutes of the various states is the amount specified in the Articles of Association as the capital, or capital stock of the corporation which is to be paid in or contributed to it, and to be represented by shares, the holders whereof shall have the right to participate in the net earnings distributed through the corporate life, and to divide among themselves on dissolution all assets remaining after the payment of the corporate debts."

And he cites by way of illustration the New York General Corporation Law, section 3:

> "A stock corporation is a corporation having a capital stock divided into shares and which is authorized by law to distribute to the holders thereof dividends or shares of the surplus profits of the corporation."

We are not in this case concerned with the meaning of the expressions "fair value of its capital stock" and "fair average value of its capital stock" as used to indicate merely the measure of the Capital Stock Tax, not the bodies subject to the tax.

In the case of *Central Union Trust Co.* v. *Edwards, Collector,* 282 Fed. 1008, affirmed by the Circuit Court of Appeals for the Second Circuit, January 8, 1923, the meaning of said terms as indicating the basis for the valuation on which the tax was to be computed was the matter in dispute. The plaintiff was a stock corporation, and no question arose as to the application of the tax to bodies of a different kind.

There is never any doubt or difficulty in determining whether a given corporation is a stock corporation or a non-stock corporation; or whether a given voluntary association or unincorporated company is or is not a joint-stock company or association.

But in the variety of forms in which taxes have been imposed upon the capital stock or shares of corporations and joint-stock companies, questions of construction often arise. The difficulty in such cases is not to identify the organizations intended to be taxed, but to determine in what sense, in a given tax Act, the term "capital stock" is used.

It may mean "capital stock authorized"; it may mean "capital stock issued." Sometimes it means the

shares as the property of the stockholders, sometimes it refers to something owned by the corporation.

Tennessee v. *Whitworth,* 117 U.S. 129.
Sturgis v. *Carter,* 114 U.S. 151.

Statutes and decisions may be found and will be cited by the defendant, in which "capital stock" has been held to mean all the property of a corporation. But this use of the term "capital stock" is unusual and inaccurate.

This usage is noticed in Cook on "Corporations" (7th ed.), volume 1, chapter 1, section 8, page 39:

> "Occasionally it happens that, under the terms of statutes relating to taxation which have been drawn without regard to the technical meaning of words, the courts will construe the capital stock to mean all the actual property of the corporation. But this is for the purpose of carrying out the intent of the statute and is not the real meaning of the term."

But none of these cases to which our attention has been called decided that a tax imposed in express terms or by necessary implication upon corporations or associations having a capital stock can be construed to apply to corporations or associations which have no capital stock.

No such inference can be drawn from these decisions.

Their meaning is, that a tax in terms levied upon the "capital stock" of a corporation may sometimes

be, in substance and effect, a tax upon all the property and franchises represented by the capital stock.

Take, for example, the Connecticut statute construed in *Security Co.* v. *Hartford,* 61 Conn. 89, where the Court said:

> "In framing our own taxation laws the capital stock of a corporation was not regarded in the strict technical sense a fixed sum of money, paid in or agreed to be paid in by the stockholders, but it was regarded as consisting of all the substantial property, real and personal, owned and possessed by the corporation. The stock of a corporation represents its property, and the stock is valuable just in proportion to the amount of such property. The market value of the stock of a corporation, therefore, is the market value of all the property of the corporation in which the stock has been invested, etc."

In the following cases similar tax acts were construed, but with no intimation that there could be any doubt as to what constituted a corporation having a capital stock:

Home Savings Bank v. *Des Moines,* 205 U.S. 503.

Delaware &c. R.R. Co. v. *Pennsylvania,* 198 U.S. 342, 354.

San Francisco Nat'l Bank v. *Dodge,* 197 U.S. 70.

The Bank Tax Case, 2 Wall. 201.

N.Y. Cent. R.R. Co. v. *Miller,* 202 U.S. 584.

DIFFERENCE BETWEEN "CAPITAL STOCK" AND "CAPITAL."

The measure of the Capital Stock Tax as levied on domestic corporations is $1 per $1000 of the *fair value of the capital stock* (in excess of $5000) Revenue Act of 1918, title X, section 1000 (1). The measure of the tax as levied on foreign corporations is $1 per $1000 of the *average amount of capital employed in business* in the United States. Revenue Act of 1918, section 1000 (2).

Also the two terms and the things they stand for are distinguished in the requirement that "in estimating the value of capital stock surplus and undivided profits shall be included."

As applied to corporations and corporate accounting "surplus" means the amount of the assets over and above liabilities and capital stock.

The distinction between "capital stock" and "invested capital" is clearly recognized in the decisions of the Courts.

Boston & Maine R.R. v. *United States*, 265 Fed. 578.

The case cited arose under the Corporation Tax Law of 1909 already referred to, which was the type and forerunner of the Capital Stock Tax, differing only in the measure adopted for fixing the amount of the tax. Among other deductions from gross income allowed in computing net income was interest paid on indebtedness "not exceeding the paid up capital stock of such corporation." The Boston & Maine contended that, as under the laws of Massachusetts it had been

required to issue large amounts of stock at a premium, it should be allowed to add the amount received as premiums to the par value of the stock in figuring its total "paid up capital stock."

The Circuit Court of Appeals held that paid-up capital stock could not exceed the par value, and that the intention of Congress was not only plain, but imperatively plain; so plain that the rule that in case of doubtful construction of a tax act the taxpayer must be given the benefit of the doubt, did not apply. We wish to call the attention of the Court to the following extracts from the Opinion (page 579 (3)):

> "As commonly known, certificates of stock represent the shares. When the shares are at face value they are at par, and when worth more they are above par, or at a premium * * * but by such fluctuations the shares of stock do not lose their identity or character as such, but remain shares of stock; and the sum total of the shares at par constitute the capital stock in the sense in which the term is ordinarily used in banking and commerce."

Here is a definition of the term "capital stock": "The sum total of the shares, at par, constitute the capital stock." And on page 580:

> "Premiums received from the sale of stock are not outstanding capital stock, and they are no more the capital stock of a railroad than is undivided surplus in a bank the capital stock of a bank."

The Court refers to the well-reasoned opinion of Judge Thomas in the District Court of Connecticut, where the same conclusion was reached.

United States v. *N.Y., N.H. & H. R.R. Co.*, 265 Fed. 331.

Attention is also called to the definitions quoted in the opinion of Judge Thomas, page 341, and to the cases cited, particularly *Boston Terminal Co.* v. *Gill, Collector,* 246 Fed. 664, and *Anderson* v. *Forty-two Broadway,* 239 U.S. 69.

In the case last cited, a corporation owning property worth millions was capitalized at a nominal amount, the capital stock being only $600; it was allowed to deduct interest on only $600, although it paid interest on indebtedness of $4,750,000.

In these cases the term "capital stock" was construed in favor of the Government and against the taxpayer, because the Court found the meaning of the term too plain for doubt. It would be strange if in construing the Capital Stock Tax, the same term should be given a different meaning, and held equivalent to "capital employed in the business," or net assets, or net worth, so as to stretch the law to cover associations not within its terms.

The Treasury Department, in another connection, has distinguished "capital stock" from "invested capital" not only in the Corporation Tax Act of 1909 but in all subsequent tax acts containing a similar provision limiting the amount of interest deductions in computing net income.

(Bulletin No. 39-20, Income Tax Rulings.)

The opinion of the solicitor may be summarized as follows:

1. The term "paid-up capital stock," as used in the Federal Tax Acts means so much of the authorized capital stock of the corporation as has been paid up to the par value of the stock subscribed, or if all the stock is subscribed, up to the amount fixed in the charter, but nothing more.

2. "Paid-up capital stock" is synonymous with the term "capital stock" as ordinarily understood, and it differs from it only when the latter is used to indicate the authorized as distinguished from the paid-in capital stock.

3. The terms do not mean the value of a corporation's property, and are not to be confused with the term "capital"; the capital stock remains fixed, although the actual property of the corporation varies in value and is constantly increasing or diminishing the amount.

The provision in the Income Tax Law of 1913 with reference to the interest deduction allowed to corporations is especially interesting as showing that Congress uses the term "capital stock" in its proper sense, distinguishing it from the amount of capital employed, which may be more or less than the capital stock:

". . . the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its

paid up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on the amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year" (Act of 1913, subdivision G (*b*) (third)).

The Revenue Act of 1916 (section 12 (*a*) (third)) contained a provision substantially the same as that just quoted from the Act of 1913; and the opinion of the solicitor above referred to holds that the term "paid-up capital stock" is to be given the same meaning. It is to be noted, in this connection, that the Capital Stock Tax first appeared in this same Revenue Act, in title IV thereof, section 407, Act of September 8, 1916.

It is submitted that the term "capital stock" must have the same meaning in section 407 as in section 12 (*a*) (third). It cannot be given one meaning in section 12, operating in favor of the Government, and a different meaning in section 407, where the meaning given it in section 12 would operate in favor of the taxpayer. The Government cannot have it both ways.

No-Par-Value Shares.

That the Circuit Court of Appeals failed to appreciate our contention and argument in this case is further shown by the language of the Opinion, where the Court said that "this plaintiff yet seeks exemption on the ground that it has attached no par value to its shares." Our contention was that the association had never had any stated or allocated capital divided into

or represented by shares, and that the certificates of beneficial interest represented merely fractional interests in a mixed fund, in part accumulated income, and all held in trust for the associates.

It is evident from the Opinion that the consideration of no-par-value shares was given much weight. No-par-value shares are a new creation of the law, and are bound to create some confusion before they find their settled place.

The Court made no reference to, and apparently overlooked, some important statutes in this connection. For example, the new statute in Massachusetts makes it clear that, at least in this State, no-par-value shares are not part of the "capital stock." On the contrary, they are excluded (Mass. Gen. Laws, chapter 156, section 47, paragraph 6).

And in the agreement of association, articles of organization, and certificate of incorporation, only shares having some par value are treated as capital stock (see Mass. Gen. Laws, chapter 156, sections 6, 10, 12).

It is clear, therefore, that, in Massachusetts, no-par-value shares are, by the very statutes creating them, not part of the "capital stock"; and on the same principle, or by analogy (if there be any), the certificates of beneficial interest of Crocker, Burbank & Co. Ass'cn cannot be "capital stock."

On the other hand, in New York the statute is quite different, and in that State the certificate of incorporation must in every case specify a stated amount of capital to be paid in, and "the amount of capital stock" of no par value "shall be deemed the aggregate amount so specified in the certificates," etc. There is no similar

provision in Massachusetts (New York Stock Corporation Law, sections 19, 20, and 23).

Provisions for shares with no *stated* par value were first adopted in New York, in 1912. Corporations issuing such shares are nevertheless required to have a fixed and stated capital. In an article in XXVI Harvard Law Review, page 729, explaining this new feature of the New York Corporation Law, Victor Morawitz said:

> "A joint stock corporation necessarily must have some capital, and it must have shareholders; and for obvious reasons of policy, it is desirable that the amount of capital which a corporation must have before incurring indebtedness and which may not be impaired by the declaration of dividends should be fixed definitely by its charter or articles of association. However, it is not necessary that the amount of capital should be fixed by reference to the nominal or par amount of the shares issued by the corporation, and it is not necessary that the shares should purport to represent specified sums of money contributed to the capital."
>
> * * * * * * * *
>
> "A corporation formed under this statute must state in its certificate of incorporation the amount of capital with which it will carry on business, * * *."

CROCKER, BURBANK & Co. ASS'CN.

Prior to the amendment of the declaration of trust made in June, 1917, the trust was a strict trust, and

not a joint-stock company or association, as was decided by the Supreme Court in *Crocker* v. *Malley*, 249 U.S. 223.

The question at issue in the case cited was whether the trust was taxable under the provisions of the Federal Income Tax Law of 1913, imposing a tax upon the net income of "every corporation, joint-stock company or association, and every insurance company organized in the United States, no matter how created or organized, not including partnerships."

After analyzing the provisions of the original declaration of trust, the opinion gives the conclusions of the Court as follows (pages 233, 234):

> "The trust that has been described would not fall under any familiar conception of a joint-stock association, whether formed under a statute or not. If we assume that the words 'no matter how created or organized' apply to 'association' and not only to 'insurance company,' still it would be a wide departure from normal usage to call the beneficiaries here a joint-stock association when they are admitted not to be partners in any sense, and when they have no joint action or interest and no control over the fund. On the other hand, the trustees by themselves cannot be a joint-stock association within the meaning of the act unless all trustees with discretionary powers are such, and the special provision for trustees in D. is to be made meaningless. We perceive no ground for grouping the two—beneficiaries and trustees—together, in order to turn them into an association, by uniting their contrasted functions and powers,

although they are in no proper sense associated. It seems to be an unnatural perversion of a well-known institution of the law."

When the Capital Stock Tax went into effect on January 1, 1917, this trust was not within its provisions. It was, as decided in *Crocker* v. *Malley,* a strict trust. The trustees then held the shares of stock of the Massachusetts corporation and title to the real estate subject to a lease to said corporation. They collected the rent and the dividends as declared by the corporation, and disbursed the same, less expenses, to the holders of the trust certificates in proportion to their respective interests.

In June, 1917, an important amendment and modification of the trust declaration was adopted in the manner therein provided (Exhibit B, Record, page).

The name of the organization was changed from "Wachusett Realty Trust" to "Crocker, Burbank & Co. Ass'cn."

It was agreed that the trust should thereafter be an "association," meetings of the beneficiaries or shareholders were provided for, and they were given power by majority vote to remove any one or more of the trustees, and elect another or others.

The trustees were authorized to take over from the Massachusetts corporation and continue, the manufacturing business which they had previously controlled only indirectly by ownership of the capital stock of the corporation.

The assets and business of the Massachusetts corporation were thus merged in the trust estate with the other property previously held in trust. The

change of title was made by simple conveyance, by appropriate instrument, from the Massachusetts corporation to the trustees.

The declaration of trust of Crocker, Burbank & Co. Ass'cn, made no provision for either "capital" or "capital stock." The certificates issued by the trustees serve as documents of title and to facilitate transfer by the beneficiaries of their rights and interests as defined in the declaration of trust. The shares have no par value. The trustees are the managers of the property held in trust, part of which is employed in manufacturing and may perhaps be termed "capital" in the economic sense, but there is no "capital stock." Nor is there any capital beyond which there could ever be any "surplus" as referred to in the Act. As the District Court found (Record, p. 14):

> "No account designated as 'capital' account has been, or is, kept by the trustees. They charge themselves in a 'profit and loss' account with all the property transferred to them, at a valuation, and show against it liabilities and reserves. The balance is carried as the net interest of the shareholders. They hold a large amount of property in which the certificate holders have a beneficial interest. The assets make up a 'property account,' not a capital."

To hold that the "shares" of Crocker, Burbank & Co. Ass'cn represent a capital stock would be to disregard entirely the language of the "certificates of beneficial interest" (Plaintiff's Exhibit 5, Record, page 19):

CERTIFICATE OF BENEFICIAL INTEREST.

No..... 96,000

CROCKER, BURBANK & CO. ASS'CN
Formerly the Wachusett Realty Trust

This is to certify that.....of .....is entitled to.....of the ninety-six thousand shares in the net proceeds of the property held under Declaration of Trust made by Alvah Crocker et ali., dated March 29, 1912, then known as "The Wachusett Realty Trust" as modified by instrument dated June 26, 1917, by which, inter alia, the name was changed to "Crocker, Burbank & Co. Ass'cn," when said property is converted into cash, and meantime to income, all as therein provided. Said original Declaration and said Modification are recorded with Worcester County, Mass. (No. Dist.) Deeds, and the terms of both said instruments are, by reference, made part hereof and expressly assented to.

The holder hereof has no interest, legal or equitable, in any specific property, and the interest hereby represented can be transferred only by due endorsement and surrender hereof and transfer noted on the books kept for the purpose by the Trustees or their Agent.

ALVAH CROCKER,
CHARLES T. CROCKER,
etc., etc., etc.

The certificates were all issued under article 4 of the original unamended declaration of trust, which reads as follows:

> Article 4. "The said Crocker, Burbank & Co., Inc., (Maine Company) having determined to wind up its affairs and be dissolved, without waiting for final cash sale of its real estate, this trust is declared in favor, and for the benefit of the eight shareholders of said Maine corporation, according to their respective fractional interests, to whom the Trustees shall issue proper receipt certificates, which certificates, and all others which may be hereafter issued in exchange or substitution therefor, shall be deemed parts hereof and conclusively evidence the ownership of respective interests in this trust; and the Trustees shall, from time to time, on request, (on surrender of the old) issue such new certificates as may be proper and necessary to evidence any new or sub-divided interests." Record, p. 6.

It is unnecessary to point out the fundamental differences both in form and substance between the above certificate and certificates for shares of capital stock as commonly issued by business corporations and by unincorporated joint-stock companies or associations.

The Circuit Court of Appeals says in its opinion (Record, page 28):

> "Parenthetically, we note that counsel do not contend that the shareholders of any of these plaintiff associations are partners," etc.

We think the Court overlooked the distinction between the ordinary partnership and the voluntary

association of many members and with transferable shares.

Certainly we claim that Crocker, Burbank & Co. Ass'cn is not an ordinary partnership; and certificate holders do not make returns as partners for Federal Income Tax purposes. The Association is taxed on its income under the Income Tax provisions of the Revenue Act, which apply to corporations, associations, joint-stock companies, and insurance companies, incorporated and unincorporated, and with or without capital stock, but not including ordinary partnerships. Revenue Act of 1916, title I, part II, section 10. And of this we do not complain.

The plaintiffs claim, however, that their association is not subject to the Capital Stock Tax, as imposed in title IV, section 407, of the same Act, which applies in terms only to bodies "having a capital stock represented by shares."

Crocker, Burbank & Co. Ass'cn is not a joint-stock company, but is an association created under a deed of trust with transferable certificates of beneficial interest. See Mass. Gen. Laws, chapter 182, section 2.

"Massachusetts trusts," so called, may be divided into three classes:

(1) Where the trustees merely hold the legal title to allow the association, through its directors, to control and manage.

Gleason v. *McKay,* 134 Mass. 419.
Howe v. *Morse,* 174 Mass. 419.

(2) Where the trustees themselves, holding the legal title, are also the managing agents of the association.

Dana v. *Treasurer & Receiver General,* 227 Mass. 562.

(3) The strict trust, where the trust is not a mere convenience for holding title and facilitating transfers of equitable interests, but where the trustees are in control of the property and business as principals.

Williams v. *Milton,* 215 Mass. 1.
Crocker v. *Malley,* 249 U.S. 223.

In the first two classes the voluntary association or partnership is the essential thing, the trust feature being adopted merely as a convenience for holding title, while in the case of the strict trust the trustees are like trustees under a testamentary trust or under a deed of settlement; the certificate holders, or *cestuis que trust,* or shareholders, have a common interest in the same sense that the members of a class of beneficiaries under trusts in a will have a common interest.

In *Priestley* v. *Treasurer & Receiver General,* 230 Mass. 452, The Warren Chambers Trust agreement was held to have created a partnership relation among the certificate holders, as distinguished from a pure trust (see Opinion, page 455) and the Court says (page 456):

> "If what is desired in order to carry out the purposes of a real estate trust is an organization with a distinct entity intermediate between a corporation and a partnership or pure trust, and with its

own rights and obligations, the Legislature and not the Court must be resorted to."

In *Frost* v. *Thompson,* 219 Mass. 360, it was held that the Buena Vista Fruit Company was a partnership, not a strict trust, and in *Horgan* v. *Morgan,* 233 Mass. 381, the decision was carried to its logical conclusion in holding the shareholdeers personally liable on the notes of said company, signed or endorsed "The Buena Vista Fruit Co., Frank E. Morris, Acting Treasurer."

The plaintiffs are the trustees of a common-law trust for the benefit of persons whose interests and rights in the trust estate are defined solely by the declaration of trust. The beneficiaries constitute an association, but an association without a capital stock.

The Circuit Court of Appeals, in commenting upon the case of *Malley, Collector,* v. *Bowditch,* 259 Fed. 809, ignored the distinction upon which the decision of the Court depended (Opinion, Record, page 27).

In the case referred to it was held that the term "stock" was not peculiar to corporations, "but a term equally applicable to the share capital or fund created by or in accordance with an agreement for the formation of an unincorporated association or company."

The case arose under a statute imposing a stamp tax on the original issue of certificates of stock. The defendants contended that the law applied only to certificates issued by corporations.

The agreement and declaration of trust, however, expressly provided for a fixed share capital of $7,668,000, divided into 76,680 shares of the par value of $100 each.

The Court says (259 Fed. 810, 811):

"The contention of the trustees that legislative action is essential to the creation of capital stock is erroneous. If there is a distinction between the 'capital' and the 'capital stock' of corporations, in that the capital stock is fixed by the charter of a corporation, but the capital used in its business may be either larger or smaller, there may be a like distinction between the joint-stock or share capital of a partnership or association, as fixed by the agreement of the partners, and the full amount of its property. Lindley on Partnership (8th Eng. Ed.) 382 et seq." * * *

"An association or company, equally with a corporation, may have a share capital distinct from its actual capital or property, irrespective of whether it is formed in a State without regulating statutes, or in a State where by statute it is regulated and given some of the characteristics of a corporation." * * *

"A certificate evidencing a share or shares of the share capital of a manufacturing company, whether incorporated, quasi-incorporated or wholly unincorporated, is properly described as a certificate of stock."

"By agreement the certificates in question were issued as evidence of shares of a fixed capital, divided into a fixed number of shares, of the par value of $100 each."

"We are called upon to apply a statute imposing stamp taxes on documents of a certain class, and which assumes that these documents may be

> issued, not only by corporations, but by associations and companies. These may have this in common—a share capital of fixed amount. Whether the share capital is fixed by agreement or under statutory authority seems immaterial, for the tax is not a franchise tax or a corporation tax, but a stamp tax or document tax."

The declaration of trust of Crocker, Burbank & Co. Ass'cn contains no provisions for a share capital of a fixed amount.

The shares have no par value. The form of the "receipt certificates" to be issued by the trustees to represent the fractional interests of the beneficiaries is not prescribed. Not even the number of shares is specified, but it is left wholly to the trustees to adopt whatever number of shares they might deem proper and convenient. The shares are issued under the provisions of paragraph No. 4 of the original declaration, and no change was made in this paragraph by the amendment or trust modification made in June, 1917.

The importance of *Malley* v. *Bowditch, supra,* in relation to the case at bar, lies in its clear recognition of the meaning of "capital stock" and "share capital" as (1) in the case of corporations, the amount of capital fixed by the charter, and (2) in the case of associations and companies, the amount of capital fixed by agreement in the articles of association or declaration of trust.

It follows, of necessity, that neither corporations like savings banks or mutual insurance companies, nor unincorporated associations and trusts like Crocker, Burbank & Co. Ass'cn, which are organized without

such provisions in their charters or articles or agreement, can be said to have a "capital stock."

Congress, in levying stamp taxes, has recognized the distinction between "certificates of stock" and other certificates representing merely fractional interests in property.

This appears by comparison of the stamp tax on issue of capital stock under Act of October 3, 1817, title VIII, war stamp taxes, with Revenue Act of 1918, title XI, stamp taxes:

(1917) Schedule A (3) Capital Stock, Issue: On each original issue, whether on organization or reorganization, of certificates of stock, by any association, company, or corporation, on each $100 of face value or fraction thereof, 5 cents.

(1918) Schedule A (3) Capital Stock, Issue: On each original issue, whether on organization or reorganization, of certificates of stock, or of profits, or of interest in property or accumulations by any corporation, on each $100 of face value or fraction thereof, 5 cents.

The Stamp Tax of 1918 is broader than that of 1917 and includes certificates of interest in property, etc., which are not certificates of stock; a complete recognition that some associations and trusts have certificates of "interest in property" which are not "certificates of stock."

The determination of the Treasury Department, by its Regulations, to make the Capital Stock Tax apply to corporations and associations whether having a capital stock or not, was first manifested in respect to mutual insurance companies, under the 1916 Act.

At first the Department had recognized that the tax

could not apply to a company or association having no capital stock (Regulations 38, issued in October, 1916, art. 2 (b), Appendix 2, *post*, p. 57): "Inasmuch as the basis of the tax is the fair value of the stock of a corporation, mutual insurance companies and other associations not having capital stock represented by shares will also be exempt from tax, in the absence of a basis for the computation of the tax."

But in 1918 the Department reversed itself, as appears by Regulations No. 38 (Revised), art. 3. Scope of Tax: Insurance Companies, Appendix 3, *post*, p. 60: "The tax also applies to insurance companies * * * irrespective of whether or not they are organized for profit or have a capital stock represented by shares."

Afterwards, in the Act of 1918, Congress made a special provision in section 1000 (*c*) for mutual insurance companies, making the tax apply to them at the rate of $1 for each $1000 of surplus and reserves, thus recognizing that non-stock companies could not be subject to a tax measured by capital stock.

As to other corporations and associations, the Department has continued to insist in its Regulations that the tax applies to all associations and joint-stock companies whether created by statute or contract, and whether or not having a capital stock represented by shares, as appears from the following excerpts from Regulations No. 50, Appendix 5, *post*, p. 68:

> Art. 11. Domestic Corporation. "* * * A corporation is liable to the tax whether it is a creature of statute or of contract and whether or not it is organized for profit or has a capital stock represented by shares."

> Art. 12. "Associations and joint-stock companies include associations, common law trusts and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds, or where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization."

The Treasury Department, by these regulations, has attempted to make the Capital Stock Tax apply to all and the same corporations, associations, and joint-stock companies that are subject to the Federal Income Tax on Corporations, ignoring the fact that, by necessary implication, the tax is imposed only on organizations having a capital stock.

This, we submit, is an attempt "to graft something on the statute that is not there" (*Smietanka* v. *First Trust and Savings Bank,* 257 U.S. 602).

In conclusion, it is respectfully urged that the decision of the Circuit Court of Appeals should be reversed and the judgment of the District Court affirmed.

> *Delk* v. *St. Louis & San Francisco R.R.,* 220 U.S. 580, 589.

We have not argued, except incidentally, the point that this case is settled by *Eliot* v. *Freeman,* because that point will be fully covered in the other cases

which were heard and decided with this case in the Court below.

We understand, however, that this Court has the whole case before it upon the record as it was presented to the Circuit Court of Appeals on writ of error.

Lutcher & Moore Lumber Co. v. *Knight*, 217 U.S. 257, 267.

FELIX RACKEMANN,
HARRISON M. DAVIS,
Of Counsel.

APPENDIX 1.

Special Excise Tax on Corporations.

BEING PART OF TITLE IV OF "AN ACT TO INCREASE THE REVENUE AND FOR OTHER PURPOSES," APPROVED SEPTEMBER 8, 1916.

(39 Stats. at Large 789.)
In effect September 9, 1916.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Title IV.—Miscellaneous Taxes.

[Sections 400 to 406 relate to the special taxes on beer, wine, spirits, etc., not included herein.]

Special Taxes.

Sec. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say:

EXCISE TAX ON CORPORATIONS.

Domestic Corporations.

Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to fifty cents for each $1,000 of the fair value of its capital stock and in estimating the value of capital stock the surplus and undivided profits shall be included: * * * The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year: Provided, That for the purpose of this tax an exemption of $99,000 shall be allowed from the capital stock as

defined in this paragraph of each corporation, joint-stock company or association or insurance company. * * * And provided further, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this Act.

Foreign Corporations.

Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States, shall pay annually a special excise tax with respect to the carrying on or doing business in the United States by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each $1,000 of the capital actually invested in the transaction of its business in the United States: * * * The amount of such annual tax shall in all cases be computed on the basis of the average amount of capital so invested during the preceding year: Provided, That for the purpose of this tax an exemption from the amount of capital so invested shall be allowed equal to such proportion of $99,000 as the amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere: * * * And provided further, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this act.

APPENDIX 2.

(T. D. 2383.)

Regulations No. 38 Relative to the Special Excise Tax on Corporations, etc., under Act of September 8, 1916.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., October 19, 1916.

REGULATIONS.

Concerning the special excise tax imposed by section 407, Title IV, act of September 8, 1916, on corporations, joint-stock companies or associations, and insurance companies, organized for profit in the United States, and on the capital invested in the United States of foreign companies and associations transacting business in the United States.

RETURNS, COMPUTATION OF TAX, COLLECTIONS, AND PENALTIES. TAX IMPOSED.

Article 1. Section 407 imposes a special excise tax with respect to the carrying on or doing business by corporations, joint-stock companies or associations, or insurance companies, as follows:

Corporations in the United States.

(*a*) Every corporation, joint-stock company or association, or insurance company, now or hereafter organized in the United States for profit and having a capital stock represented by shares, 50 cents for each $1,000 of the fair value of the capital stock in excess of $99,000, except as hereinafter indicated; and

Foreign Corporations.

(*b*) Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States, 50 cents for each $1,000 of the capital actually invested in the transaction of its business in the United States. It is provided in cases in which the foreign corporation

makes a return of the total amount of capital invested in the transaction of business, both abroad and in this country, that such proportion of $99,000 as the amount invested in the United States bears to the total amount invested in the United States and elsewhere may be remitted in computing the tax upon the capital invested in the United States.

Corporations Exempt.

Corporations and Associations Exempt.

Art. 2. (*a*) The following corporations, joint-stock companies or associations, or insurance companies, which are exempt from income tax under the provisions of section 11, Title I, are also specifically exempt from the capital-stock tax under section 407, Title IV, of this act:

First. Labor, agricultural, or horticultural organization;

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association, or their dependents;

Fourth. Domestic building and loan association and co-operative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized

for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or co-operative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the act approved July seventeenth, nineteen hundred and sixteen, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Mutual Companies Exempt.

(*b*) Inasmuch as the basis of tax is the fair value of the stock of a corporation, mutual insurance companies and other associations not having capital stock represented by shares will also be exempt from tax, in the absence of a basis for the computation of the tax.

RETURNS.

Tax Due in January and July, 1917, and Annually in July Thereafter.

Art. 3. (*a*) [Omitted.]

Returns Required of Every United States Corporation Having Capital Stock Outstanding of $75,000 or Over.

(*b*) Every corporation, joint-stock company or association, or insurance company, organized in the United States for profit and having a capital stock issued and outstanding, represented by shares of the market value of $75,000 or over, and not exempt as indicated in article 2, shall make a return on Form 707 irrespective of the par value of its capital stock, unless such corporation, joint-stock company or association, or insurance company was not engaged in business during the preceding taxable year, which for the return due January 1, 1917, shall be the fiscal year July 1, 1915, to June 30, 1916.

Return Required of Every Foreign Corporation.

(*c*) Every corporation, joint-stock company or association, or insurance company, organized for profit under the laws of any foreign country and engaged in business in the United States, shall make return on Form 708 irrespective of the amount of capital employed either at home or in this country in the transaction of its business.

FORM OF RETURN FOR UNITED STATES CORPORATIONS.

Substance of Return Required from United States Corporations.

Art. 4. The return required by article 3 of corporations, joint-stock companies or associations, or insurance companies, organized in the United States, shall be made on Form 707, to be supplied by this department, and shall set forth the following particulars:

(1) Total number of shares of stock now outstanding.

(2) Par value of shares.

(3) Par value of total capital stock outstanding.
(4) Amount of surplus.
(5) Amount of undivided profits.
(6) *Case I.*—Average market value per share during preceding fiscal year, if stock is listed on an exchange.

Case II.—If stock is not listed on an exchange, average market value per share computed from sales made during preceding fiscal year.

Case III.—If stock is not listed on any exchange and no sales have been made during preceding fiscal year, or if sales have been made and the price is unknown, the fair average value of the stock may be estimated from the following data set forth on the return: Amount of surplus, amount of undivided profits, nature of business, estimated earning capacity, average dividends per share paid during preceding five years, average profits per share earned during preceding five years.

(7) Total number of shares of stock outstanding on last day of fiscal year.
(8) Fair value of total capital stock for preceding fiscal year.
(9) Deduction allowed by law of $99,000.
(10) Amount of fair value of stock over $99,000 upon which tax should be computed.
(11) Tax at rate of 50 cents per year for each full $1,000.
(12) Amount of munitions tax, if any, paid under Title III of this act since making the last previous return.
(13) Amount of tax due.

Form of Return for Foreign Corporations.

Substance of Return Required of Foreign Corporations.

Art. 5. The return required by article 3 of foreign corporations, joint-stock companies or associations, or insurance companies, having capital invested in the transaction of its business in the United States, shall be made on Form 708, to be supplied by this department, and shall set forth the following particulars:

(1) Amount of capital invested in the United States.

(2) Amount of capital invested in foreign countries.

(3) Total amount of capital invested in the corporation, both in the United States and elsewhere.

(4) Percentage of capital invested in the United States.

(5) Percentage of $99,000 allowed to be deducted under the law.

(6) Amount of capital upon which tax should be computed.

(7) Tax at the rate of 50 cents per year for each full $1,000.

(8) Amount of munitions tax, if any, paid under Title III of this act since making the last previous return.

(9) Amount of tax due.

COMPUTATION OF TAX.

United States Corporations.

Art 6. Sec. 1. *Companies or associations organized in the United States for profit.*—The tax on companies or associations having a capital stock represented by shares is imposed on the fair average value for the preceding year and not the face or par value of the capital stock. The fair value of the capital stock shall be ascertained as follows:

Stock Listed on Exchange.

(*a*) *Case I.*—If the stock is listed on any exchange its fair value will be determined by adding the quoted highest bid price for the stock on the last business day of each month during the preceding fiscal year (or if no bid price was quoted on the last day then the latest day in the month on which a bid was quoted), and dividing by 12, the result being the average bid price per share for that year.

Stock not Listed, but of which Sales have been Made.

(*b*) *Case II.*—If the stock is not listed on any exchange, but sales thereof have been actually made, and

the price paid for the stock is known to the officer making the return, or can be discovered by him, the average price at which sales were made during the preceding fiscal year shall be the determining factor in ascertaining the fair value per share.

(In the foregoing two cases the actual fair value of the stock is ascertainable from the facts without the necessity of making an estimate.)

Cases in which Fair Average Value of Stock shall be Estimated.

(*c*) *Case III.*—If Case I and Case II can not be applied, viz., the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return, the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into considerataion as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid, or profits earned during the preceding five years.

Fair Value of Total Capital Stock Outstanding.

(*d*) The fair value per share ascertained or estimated as above multiplied by the number of shares outstanding will give the fair value of the stock for taxation purposes.

Deduction of $99,000.

(*e*) From this total will be deducted the sum of $99,000, the exemption allowed by law, and the tax will be laid upon the balance at the rate of 50 cents for each full $1,000 of the remainder.

Tax Due January, 1917.

(*f*) Upon the returns to be made during January, 1917, for the six months ending June 30, 1917, the tax due will be 25 cents per $1,000 of such remainder.

Deduction of Munitions Tax.

[Omitted.]

FOREIGN CORPORATIONS.

SEC. 2. *Corporations, joint-stock companies or associations, or insurance companies, organized for profit under the laws of any foreign country and engaged in business in the United States.*

(*a*) The tax imposed on such companies or associations shall be computed upon the actual capital invested in the transaction of its business in the United States. The basis of taxation is the *average* amount of capital so invested during the preceding fiscal year.

Deduction of Proportion of $99,000 only Allowed if Corporation Makes Return of Total Capital Invested.

(*b*) The exemption from the amount of capital invested in the United States equal to the proportion of $99,000 as the amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere shall only be allowed a company or association which makes return to the Commissioner of Internal Revenue, under these regulations, of the amount of capital invested in the transaction of business outside of the United States. Thus a foreign company or association investing part of its capital in the transaction of business in the United States shall be liable for tax in the amount of 50 cents for each $1,000 of the actual capital invested in the United States, without deduction of the said proportion of $99,000, unless it discloses in its return the amount of capital invested in the transaction of business outside of the United States.

CORPORATIONS NOT IN BUSINESS DURING PRECEDING TAXABLE YEAR.

SEC. 3. *Corporations not engaged in business during preceding taxable year.*—This tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or in the case of the taxable period ending June 30, 1917, not so engaged during the year July 1, 1915, to June 30, 1916. The

tax shall be computed upon each full value of $1,000 and not on any fractional part thereof.

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APPENDIX 3.

Regulations No. 38 Revised

(August 9, 1918)

(T. D. 2750.)

RELATING TO THE CAPITAL STOCK TAX UNDER TITLE IV OF THE ACT OF SEPTEMBER 8, 1916.

DOMESTIC CORPORATIONS.

Article 1. Due date.—The tax became effective January 1, 1917, and is to be paid annually in advance for each year beginning July 1, except as to the first payment for the six months ending June 30, 1917. Special taxes, of which this is one, become due on the 1st day of July in each year, or on commencing any trade or business on which such tax is imposed. In the former case the tax is reckoned for one year, and in the latter case it is reckoned proportionately, from the first day of the month in which the liability to a special tax commenced to the 1st day of July following. But see Article 11. No tax is refundable if a corporation ceases to do business during the year.

Art. 2. Scope of tax: Corporations and joint-stock companies.—The tax applies to every corporation, joint-stock company or association (except insurance companies), now or hereafter organized in the United States for profit and having a capital stock represented by shares, irrespective of whether it is the creature of statute or of contract. A corporation is organized for profit if its stockholders or members may benefit pecuniarily from its operations. Joint-stock associations not organized under any statute and so-called Massachusetts trusts are subject to the tax. Limited partnerships of the New York type, having practically no characteristics of a corporation or joint-stock company except limited liability as to some of the partners, are not within the scope of the tax, but Pennsylvania

partnerships with limited liability and similar so-called limited partnerships or partnership associations, having perpetual succession and capable of taking title to real estate and suing in the common name, are subject to the tax, although they may not issue stock certificates to evidence the shares of the members.

Art. 3. Scope of tax: Insurance companies.—The tax also applies to insurance companies which are organized under a statute or derive from that source some quality or benefit not existing at the common law, irrespective of whether or not they are organized for profit or have a capital stock represented by shares. Mutual and participating plan companies are included. A mutual protective association organized under a statute, whose only source of revenue is the assessments paid by its members and whose net income for each year is paid into a reserve fund, constituting the sole resource of the company, aside from current assessments, for the payment of losses, is an insurance company within the meaning of the statute.

Art. 4. Basis of tax.—The tax is imposed "with respect to the carrying on or doing business" by a corporation. It may be described generally as a tax upon the doing of business in the capacity of a corporation, joint-stock company, or insurance company. "Business" is a very comprehensive term and embraces everything about which a person can be employed. Every corporation that is doing business, and no corporation that is not carrying on or doing business, is subject to the tax. As corporations are organized to do business, every existing corporation will be presumed to be subject to the tax unless it submits proof satisfactory to the Commissioner of Internal Revenue that it is not doing business. The distinction is between the mere ownership of property and the actual doing of business in the capacity above designated. The fair test is whether a corporation has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, or is still active and is maintaining its organization for the purpose of

continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes.

Art. 5. "Doing Business" Illustrated. [Omitted.]

Art. 6. Not "Doing Business." [Omitted.]

Art. 7. Rate of Tax.—The tax is at the rate of 50 cents for each full $1,000 of the fair value of the capital stock of a corporation, in estimating which the surplus and undivided profits shall be included. The tax is not upon the par value of the capital stock, but upon its fair average value for the preceding fiscal year ending June 30. As regards domestic corporations, it is on an entirely different basis from the excess profits tax, which is concerned with invested capital and not with the present fair value of the capital. Moreover, the fair value of the entire capital stock of a corporation is not necessarily the product of the market value of each share multiplied by the number of shares. For the method of computation of the tax, see article 18. Stock in the treasury of a corporation is not regarded as outstanding. No deduction is allowed corporations organized in the United States for capital invested outside the United States. If a corporation is doing any business, it is taxed on its entire capital stock, even though most of it may not be employed in the business.

Art. 8. Proviso as to Insurance Companies.—In ascertaining the value of their capital stock for the purpose of the tax such deposits and reserve funds of insurance companies as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders are to be omitted. Aside from such legal reserve funds the capital stock of mutual insurance companies consists of any capital or surplus or contingent reserves invested in real estate and other assets or maintained for the general use of the business.

Art. 9. Deduction of $99,000.—From the total fair value of the capital stock the sum of $99,000 is deductible and the tax is upon each full $1,000 of any balance. Accordingly, corporations the fair value of whose capital stock is not more than $99,000 are not subject to any tax. However, for the purpose of avoid-

ing errors *every* corporation must file a return as directed in Article 18, even though the par value or the fair value of its capital stock does not exceed $99,000.

Art. 10. Credit of Munition Manufacturer's Tax. [Omitted.]

Art. 11. Corporation Not in Business During Preceding Year. [Omitted.]

Art. 12. Exempt Corporations.—The tax does not apply to the following corporations exempt from income tax under the provisions of section 11 of Title I of the Act of September 8, 1916:

[Omitted; same as in first issue of Regulations.]

FOREIGN CORPORATIONS.

Art. 13. Foreign corporations: Scope of tax.—The tax is payable by every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States. In general, the same kinds of companies and associations are included as in the case of domestic corporations, except that to be taxable they must be organized under some statute or derive from that source some quality or benefit not existing at the common law. A foreign corporation is engaged in business in the United States if it maintains agents or an office or warehouse here, or in the case of an insurance company writes insurance policies here, or in any other way enters the United States for the purpose of its business.

Art. 14. Foreign corporations: Rate of tax.—The tax is at the rate of 50 cents for each full $1,000 of the capital of the foreign corporation actually invested in the transaction of its business in the United States, and is in all cases to be computed on the basis of the average amount of capital so invested during the preceding year, except for the deduction of legal reserve funds in the case of insurance companies. The basis of the tax is accordingly different from that in the case of domestic corporations, which pay a tax measured by the fair value of their capital stock. For the method of computation of the tax, see article 20.

Art. 15. Foreign corporations: Deduction.—In ascertaining the taxable invested capital an exemption from the amount of capital invested in the United States is allowed equal to such proportion of $99,000 as the amount so invested bears to the total amount of invested capital of the corporation, but this exemption applies only if the corporation makes return of the amount of capital invested in the transaction of business in the United States and elsewhere as directed in article 20, and a corporation making no return of capital invested outside the United States, irrespective of the size of its capital, is entitled to no deduction.

Art. 16. Foreign corporations: Credit and exemptions.—A credit of any payment of the munition manufacturer's tax and the exemption from tax of certain corporations apply alike to foreign corporations and to domestic corporations. See Articles 10, 11 and 12. "Engaged in business" in the case of a foreign corporation means engaged in business in the United States.

ADMINISTRATIVE PROVISIONS.

Art. 17. Punishment for violation. [Omitted.]

Art. 18. Return by domestic Corporations.—Every domestic corporation shall make return on Form 707 (Appendix A), regardless of the par value of its capital stock. The fair average value of the capital stock of a corporation and the tax payable thereon shall be determined in accordance with the instructions in the form, which provides in Exhibit A for the book value of the capital stock, in Exhibit B for the market value, and in Exhibit C for the value based on capitalizing the earnings. All the information called for must be given in every case where it is procurable.

Art. 19. "Fair value" of capital stock.—The fair value of capital stock, the statutory basis of the tax, is not necessarily the book value, or the market value, or even the earning value, although it is often more directly dependent upon the last. It can best be estimated by officers of the corporation having special

knowledge of its affairs and general knowledge of the line of business in which it is engaged. Provision is accordingly made in Exhibit C of Form 707 for the determination of the fair value of the capital stock by capitalizing the net earnings of the corporation on a percentage basis fixed by its officers as fairly representing the conditions obtaining in the trade and in the locality. But such fair value must not be set at a sum less than the reconstructed book value shown by Exhibit A or the market value shown by Exhibit B, unless the corporation is materially affected by extraordinary conditions which justify a lower figure. The Commissioner of Internal Revenue will estimate the fair value of the capital stock in cases regarded as involving any understatement or undervaluation. When a second assessment is made in case of any return which in the opinion of the collector was false or fraudulent, or contained any understatement or undervaluation, no tax collector under such assessment shall be recovered by any suit unless it is proved that the return was not false or fraudulent and did not contain any understatement or undervaluation.

Art. 20. Return by foreign corporations.—Every foreign corporation shall make return on Form 708 (Appendix B), irrespective of the amount of capital employed either at home or in this country in the transaction of its business. The capital actually invested in the transaction of the business of a foreign corporation in the United States and the tax payable thereon shall be determined as follows:

(1) Take the entire invested capital of the corporation, as shown by its last return within the year ending June 30 for the purpose of the war excess profits tax imposed by the Act of October 3, 1917, or if no such excess profits tax return has been made by the corporation, compute the invested capital for its fiscal year ending within the year ending June 30 in accordance with the War Excess Profits Tax Regulations.

(2) Find the proportion, expressed in percentage, which the net income from sources within the United States bears to the entire net income for the fiscal year ending within the year ending June 30, such in-

come being ascertained upon the same basis and in the same manner as for the income and excess profits taxes.

(3) Apply the percentage found in (2) to the average invested capital ascertained in (1), the result being the amount of capital invested in the United States.

(4) Apply the percentage found in (2) to $99,000, and subtract the result from the amount of capital invested in the United States, as ascertained in (3).

(5) Compute the amount of the tax at the rate of 50 cents for each full $1,000 of the net amount of capital invested in the United States, as ascertained in (4).

(6) Subtract the amount of the munition manufacturer's tax, if any, paid under Title III of the Act of September 8, 1916, since the last previous return.

(7) The result of (6) is the net amount of tax due.

Art. 21. Time for making return. [Omitted.]

Art. 22. Penalty for failure to make or for false return. [Omitted.]

Art. 23. Time of Payment of Tax. [Omitted.]

Art. 24. Miscellaneous Provisions.—So-called subsidiary corporations, all or a part of the stock of which is owned by another corporation, must render returns in the same way as other corporations. No deduction is allowed in the return of a holding corporation for the tax paid by a subsidiary. The term "corporation" is used in these regulations for convenience to include also "joint-stock company or association" and "insurance company." "United States" includes the States, the Territories of Alaska and Hawaii, and the District of Columbia.

APPENDIX 4.

Special Excise Tax on Corporations.

BEING PART OF TITLE X OF THE REVENUE ACT OF 1918.
(ACT OF FEB. 24, 1919.)
(40 Stats. at Large 1057.)

Sec. 1000 [of Title X of the Revenue Act of 1918]. (a) That on and after July 1, 1918, in lieu of the tax

imposed by the first subdivision of section 407 of the Revenue Act of 1916.

[*Domestic Corporations.*]

(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June thirtieth as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

[*Foreign Corporations.*]

(2) Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to $1 for each $1,000 of the average amount of capital employed in the transaction of its business in the United States during the preceding year ending June thirtieth.

[*Insurance Companies.*]

(b) In computing the tax in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders shall not be included.

[*Exempt Corporations.*]

(c) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or in the case of a foreign corporation not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in section 231.

[*Mutual Insurance Companies.*]

The taxes imposed by this section shall apply to mutual insurance companies, and in the case of every such domestic company the tax shall be equivalent to $1 for each $1,000 of the excess over $5,000 of the sum of its surplus or contingent reserves maintained for the general use of the business and any reserves the net

additions to which are included in net income under the provisions of Title II, as of the close of the preceding accounting period used by such company for purposes of making its income tax return: Provided, That in the case of a foreign mutual insurance company the tax shall be equivalent to $1 for each $1,000 of the same proportion of the sum of such surplus and reserves, which the reserve fund upon business transacted within the United States is of the total reserve upon all business transacted, as of the close of the preceding accounting period used by such company for purposes of making its income tax return.

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[*Credit for 1918-1919 Special Excise Tax already Paid.*]

Sec. 1004. * * * If the corresponding tax imposed by section 407 of the Revenue Act of 1916 was not payable by stamp, the amount paid under such section for any period for which a tax is also imposed by this title may be credited against the tax imposed by this title.

[*Note:* The foregoing Sec. 1000, in terms, applies only to corporations; but it is to be read in connection with the definitions following:

TITLE I.

General Definitions.

Section 1. That when used in this Act the term "person" includes partnerships and corporations, as well as individuals.

The term "corporation" includes associations, joint-stock companies, and insurance companies.

The term "domestic" when applied to a corporation or partnership means created or organized in the United States.]

APPENDIX 5.

Regulations No. 50.

[Released May 3, 1919.]

RELATING TO THE CAPITAL STOCK TAX UNDER TITLE X OF THE REVENUE ACT OF 1918.

IMPOSITION OF TAX.

Article 1. Due Date of Tax.—The tax became effective as of July 1, 1918, and is to be paid annually in advance for each year beginning July 1, in lieu of the capital stock tax imposed by the Revenue Act of 1916. The tax for the first year ending June 30, 1919, although necessarily not payable in advance, must be paid upon notice and demand by the collector. See article 111. Special taxes, of which this is one, become due on the 1st day of July in each year, or on commencing any trade or business on which such tax is imposed. In the former case the tax is reckoned for one year, and in the latter case it is reckoned proportionately from the first day of the month in which the liability to a special tax commenced to the 1st day of July following. But see article 51. No tax is refundable if a corporation ceases to do business during the year.

TAX ON DOMESTIC CORPORATIONS.

Art. 11. Domestic Corporation.—The tax applies to every domestic corporation. The term "corporation" includes associations, joint-stock companies and insurance companies, but not partnerships properly so-called. The term "domestic" means created or organized in the United States, including only the states, the Territories of Alaska and Hawaii, and the District of Columbia. A corporation is liable to the tax whether it is a creature of statute or of contract and whether or not it is organized for profit or has a capital stock represented by shares.

Art. 12. Domestic Corporation: Association.—Associations and joint-stock companies include associations, common law trusts and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State

laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. But see articles 13-15.

Art. 13. Domestic Corporation: Association Distinguished From Partnership.—An organization the membership interests in which are transferable without the consent of all the members, however the transfer may be otherwise restricted, and the business of which is conducted by trustees or directors and officers without the active participation of all the members as such, is an association and not a partnership. A partnership bank conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other members is a joint-stock company or association within the meaning of the statute. A partnership bank the interests of whose members can not be so transferred is a partnership.

Art. 14. Domestic Corporation: Association Distinguished from Trust.—Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists. If, however, the cestuis que trust have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute.

Art. 15. Domestic Corporation: Limited Partnership as Partnership.—So-called limited partnerships of the type authorized by the statutes of New York and most of the States are partnerships and not corporations within the meaning of the statute. Such limited partnerships, which can not limit the liability

of the general partners, although the special partners enjoy limited liability so long as they observe the statutory conditions, which are dissolved by the death or attempted transfer of the interest of a general partner, and which can not take real estate or sue in the partnership name, are so like common law partnerships as to render impracticable any differentiation in their treatment for tax purposes. Michigan and Illinois limited partnerships are partnerships. A California special partnership is a partnership.

Art. 16. Domestic Corporation: Limited Partnership as Corporation.—On the other hand, limited partnerships of the type of partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and of a few other States are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, and capable of holding real estate and bringing suit in the common name, are more truly corporations than partnerships and must pay the tax as corporations. In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. Michigan and Virginia partnership associations are corporations. Such a corporation may or may not be a personal service corporation.

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Art. 22. Rate of Tax.—The tax is at the rate of $1 for each full $1,000 of the fair average value of the capital stock of a corporation in excess of the prescribed deduction. The tax is not upon the par value of the capital stock, but upon its fair average value for the preceding fiscal year ending June 30. As regards domestic corporations it is on an entirely different basis from the excess profits tax, which is concerned with invested capital and not with the present fair value of the capital. Moreover, the fair value of the entire capital stock of a corporation is not necessarily the product of the market value of each share

multiplied by the number of shares. For the method of computation of the tax see article 102. Stock in the treasury of a corporation is not regarded as outstanding unless pledged as security for a debt. No deduction is allowed corporations organized in the United States for capital invested outside the United States. If a corporation is doing any business, it is taxed on its entire capital, even though most of it may not be employed in the business.

Art. 23. Deduction of $5,000.—From the total fair average value of the capital stock the sum of $5,000 is deductible and the tax is upon each full $1,000 of any balance. Accordingly, corporations the fair value of whose capital stock is not more than $5,000 are not subject to any tax. However, for the purpose of avoiding errors *every* corporation must file a return as directed in article 101, even though the par value or the fair average value of its capital stock does not exceed $5,000.

Art. 24. Inclusion of Surplus.—The surplus and undivided profits must be included in estimating the fair average value of the capital stock; that is to say, the capital stock, representing the entire ownership of the property of a corporation, necessarily includes the surplus and undivided profits. If the fair average value is determined from the book value they are included in the assets; if from sales, they are necessarily taken into consideration in establishing the market price, and if from net income, they are more or less reflected through the earnings.

Tax on Foreign Corporations.

Art. 31. Foreign Corporation: Scope of Tax.—The tax is payable by every foreign corporation engaged in business in the United States. The term "foreign" means created or organized outside the United States. In general, the same kinds of companies and associations are included as in the case of domestic corporations. See articles 11-16. A foreign corporation is engaged in business in the United States if it maintains agents or an office or warehouse here, or in the case of an insurance company writes insurance poli-

cies here, or in any other way enters the United States for the purpose of its business.

Art. 32. Foreign Corporation: Rate of Tax.—The tax is at the rate of $1 for each full $1,000 of the capital of a foreign corporation actually employed in the transaction of its business in the United States, and is in all cases to be computed on the basis of the average amount of capital so employed during the preceding year ending June 30. The basis of the tax is accordingly different from that in the case of domestic corporations, which pay a tax measured by the fair average value of their capital stock. No deduction from the total fair average value is allowed in computing the tax.

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Art. 35. Foreign Corporation: Average Amount of Capital Employed.—The basis of the tax is the average amount of capital employed in the transaction of business in the United States during the preceding fiscal year. It will usually be sufficient to determine the amount of capital so employed at the beginning of such year and the amount so employed at the end of such year and to divide the sum of such amounts by two. However, where there have been material changes in the amount of capital the average amount should be determined with due regard to the times at which such changes occurred. The foreign corporation may, if desired, compute the average amount of capital employed on a monthly basis.

Tax on Stock Insurance Companies.

Art. 41. Stock Insurance Company.—Insurance companies having capital stock, as distinguished from mutual insurance companies, are taxable like other corporations, whether domestic or foreign. In ascertaining the fair value of their capital stock for the purpose of the tax, however, such deposits and reserve funds of insurance companies as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders, and reserves which represent actually accrued

liabilities, the credits to which are deducted from gross income as ordinary and necessary business expenses, are to be omitted from the calculation. But if the fair average value is estimated from the market price of the shares of stock of the company, no deduction for deposits or reserves is proper from the total value so established.

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Art. 52. Exempt Corporations.—The tax does not apply to the following corporations: [Omitted; list substantially same as in prior law.]

TAX ON MUTUAL INSURANCE COMPANIES.

Art. 61. Mutual Insurance Company.—The tax applies to domestic and foreign mutual insurance companies. A mutual protective association organized under a statute, whose only source of revenue is the assessments paid by its members and whose net income for each year is paid into a reserve fund, constituting the sole resource of the company, aside from current assessments, for the payment of losses, is an insurance company within the meaning of the statute. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer.

Art. 62. Domestic Mutual Insurance Company: Rate of Tax.—The tax is $1 for each full $1,000 of the excess over $5,000 of the sum of (*a*) the surplus or contingent reserves maintained for the general use of the business and (*b*) any reserves the net additions to which are included in net income for the purpose of the income tax, in both cases figured as of the close of the last taxable year of the company. The net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds and, in the

case of corporations issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium payment plan continuing for life and not subject to cancellation, including such portion of the net addition not required by law made within the taxable year to reserve funds as is needed for the protection of the holders of such combination policies, is not included in net income for the purpose of the income tax. See Regulations 45 and particularly articles 568-570 thereof.

Art. 63. Foreign Mutual Insurance Company: Rate of Tax.—The tax is $1 for each full $1,000 of the same proportion of the sum of (*a*) and (*b*) in the last article which the reserve fund upon business transacted within the United States is of the total reserve upon all business transacted, calculated as of the close of the last taxable year of the company.

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